VZCZCXRO3487
RR RUEHDT RUEHPB
DE RUEHPT #0019/01 0780743
ZNY CCCCC ZZH
R 190743Z MAR 09
FM AMCONSUL PERTH
TO RUEHC/SECSTATE SECSTATE WASHDC
INFO RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEHBY/AMEMBASSY CANBERRA 0396
RUEHDN/AMCONSUL SYDNEY 0291
RUEHBN/AMCONSUL MELBOURNE 0287
RUEHPT/AMCONSUL PERTH 0420
RUCNARF/ASEAN REGIONAL FORUM COLLECTIVE
RUEHGH/AMCONSUL SHANGHAI 0003
RUEHGZ/AMCONSUL GUANGZHOU 0001
RUEHHK/AMCONSUL HONG KONG 0001

C O N F I D E N T I A L SECTION 01 OF 03 PERTH 000019

SIPDIS

STATE FOR EAP/ANP, EAP/CM, AND EEP
DOE FOR JEFF SKEER

E.O. 12958: DECL: 3/19/2019
TAGS: EMIN EINV ECON PREL CH AS
SUBJECT: WA MINERS WELCOME STEPPED-UP CHINESE INVESTMENT

REF: (A) CANBERRA 117, (B) CANBERRA 143, (C) 08 PERTH 42

PERTH 00000019 001.2 OF 003

CLASSIFIED BY: Kenneth Chern, Consul General, EXEC, State.
REASON: 1.4 (b), (d)

¶1. (C) Summary: The proposed acquisition by Chinese company Chinalco of a significant stake in Anglo-Australian mining giant Rio Tinto (ref A) has sparked widespread debate in the Western Australia (WA) mining sector over the prospects for increased Chinese investment in the state's iron ore and other mineral assets. Across the board, WA businesses say they welcome more - and more sophisticated, as evidenced by Chinalco - Chinese investment. Concerns remain, however, that China could take advantage of cash-strapped mining companies to gain control of resources and keep prices low, to the detriment of future Australian generations. Resident Chinese company Sinosteel believes Chinese investors will simply take their cash elsewhere if Australian companies do not want it. The Australian mining sector is relying heavily on economic recovery in China to boost commodity prices (septel). Given the uncertainty over when and to what extent this recovery will occur, nearly all the businesses we spoke with believe the Australian Foreign Investment Review Board (FIRB) will give the go-ahead to the Chinalco deal, and to other deals under consideration like the agreement of Fortescue Metals Group (FMG) with Hunan Valin and Steel. End Summary.

CHINESE INVESTMENT WELCOME . . .
--- --------

¶2. (C) In a series of private meetings with the Consul General, key WA business and government officials were cautiously positive about the implications of Rio Tinto's U.S.$19.5 billion deal with Chinalco, announced in February. Premier Colin Barnett told the CG that WA, which historically has depended on foreign investment to develop its abundant minerals resources, welcomed Chinese investment "with appropriate safeguards," such as limiting the number of board seats to a minority. He said that in the past, Chinese investors had used a "ham-fisted" approach to investing in Australia, "likely similar to their approach in Africa where they would buy the resources, build the mine and own the whole project." He contrasted the Chinese to the "sophisticated and productive" experience WA has had with the Japanese, but said the Chinalco deal signals "a maturing of the investment relationship between China and Australia." Li Shugang, Chinese Consul General in Perth, has told the CG privately that following two visits from Barnett, he is confident that the Chinalco deal will go through - it was a

win-win for both countries. Other experienced mining hands like Tim Shanahan, former head of the state's leading mining lobby, the Chamber of Minerals and Resources, echoed the view that the Chinalco deal represents "progress" and greater sophistication on the part of Chinese companies.

. . . BUT CHINESE CONFIDENCE AND INTENTIONS PROMPT UNEASE . . .
--- --------------

¶3. (C) Duncan Calder, President of the Australia China Business Council (WA) and an experienced China hand, told the CG that the way the Chinalco deal is unfolding is a "reflection of the emerging confidence on the part of the Chinese." As Calder put it, the Chinese "are holding the cash and intend to use it during these tough economic times to buy strategic assets in their long-term interest." Calder believes the Chinalco development is "scary," arguing that the deal signals that the Chinese are more interested in taking stakes in producing infrastructure and assets, but less willing to invest in new development.

. . . AND BHP-BILLITON SAYS FIRB WILL REJECT THE DEAL
--- --------------

¶4. (C) An exception to the consensus that the Chinalco deal will go through came from Ian Fletcher, BHP-Billiton's Vice President, External Affairs, who believes that FIRB will recommend against approval. (Comment: BHP has been a leading voice in using its considerable influence to lobby Canberra to block the Chinalco deal. End Comment.) Fletcher told the CG that it would be logistically impractical to exclude the two proposed Chinese board members from internal company financial and pricing data. He compared the Chinalco deal with earlier deals struck by Japanese corporations for investments in WA and other parts of Australia. He noted that while Japanese pubic companies were not tied to the Japanese government, the case for

Chinese firms like Chinalco was "a lot murkier." Implicitly backtracking, however, Fletcher conceded that if the FIRB did approve the Chinalco deal, the Australian Competition and Consumer Commission (ACCC) would set strict criteria for how the deal will be implemented.

FMG AND THE FAMILY FARM

¶5. (C) Fortescue Metals Group insider Sandra Liu, in charge of China marketing for Australia's third-largest iron ore producer, told the CG the prospect of increased Chinese investment activity in WA is a "tricky one." She said that WA should be careful not to "sign away its future resource" but warned that "the Chinese are here with the cash and they weren't born yesterday." She cited the experience of Sinosteel (formerly China Metallurgical Import and Export Corporation, CMIEC), which contributed 40 percent to the Channar Iron Ore project with joint venture partner Rio Tinto and is contractually obligated to market the ore, currently contributing to parent company Sinosteel's losses. Liu said "China wants better deals than this now."

FMG DEAL REFLECTS TOUGH ENVIRONMENT
--- -------------------

¶6. (C) Liu confided that FMG's recent deal with leading Chinese steel mill Valin Iron and Steel Group (Valin) reflects the current tough times. Valin agreed in late February to pay FMG A$558 million (U.S.$369 million) to take a 7.5 percent stake in the company. On March 9, Valin agreed to pay a further A$86.8 million (U.S.$57 million). Valin also bought an additional nine-percent stake in FMG from U.S. capital fund Harbinger, bringing Valin's total shareholding in FMG to 17.4 percent. The deal is subject to approval by the FIRB and FMG shareholders.

¶7. (C) While Liu said that Valin has a good reputation as a "very private-sector-oriented" Chinese company, she remarked that FMG could have had a "much better deal" last year when investors were considering taking a U.S.$1 billion stake in FMG shares worth three times the current price. According to Liu, Valin is guaranteed five million tons of iron ore per year. She added that "A$15 million essentially buys a company a place at the FMG table" - that is, one million tons per year. FMG has publicly stated that the cash injection from Valin will underpin plans to ramp up production from 55 million tons per year to 120 million tons per year, but analysts say the funds may go to easing the company's debt. FMG currently plans to produce 30 million tons of iron ore in 2009.

RESIDENT SINOSTEEL FRANK ABOUT ECONOMIC REALITY
--- --------------

¶8. (C) WA's resident Sinosteel Managing Director "Jack" Cui Xiaofei was also frank about the reality of financing options available to Australian miners. Cui has headed up the Australian operations for Sinosteel, China's largest iron ore importer and trader, for a decade. In a private meeting Cui told the Consul General that he believes the FIRB will approve the Chinalco - Rio Tinto deal. If it does not, he said, then "Chinalco can put its cash back in its pocket and spend it somewhere else, maybe in South Africa or Germany, for example." Cui, who speaks very good English but has been a reserved interlocutor in past meetings, was voluble this time, often speaking in Mandarin. Commenting on the current economic crisis, he spoke animatedly about the double meaning of the Chinese word for crisis - "weiji" - as both danger and opportunity. Australians, Cui warned, must decide whether Chinese investment represents more of an opportunity than a danger.

NO CHINESE INVESTMENT IN WA PORT INFRASTRUCTURE
--- --------------

¶9. (C) Other stakeholders representing prospective Chinese investments have expressed concerns about growing public politicization of Chinese investment issues. John Saunders, CEO of Yilgarn Infrastructure, believes this is the case for potential Chinese investment in WA's emerging iron-ore Midwest region. Last July, Yilgarn, which is backed by five Chinese

state-owned companies, unsuccessfully competed against a Mitsubishi-led Japanese-backed consortium for the right to build the new privately-funded Oakajee deepwater port (ref C). Yilgarn believed it was in a competitive position for a subsequent and separate tender to build a rail line to the port.

¶10. (C) The Barnett state government, however, has put the port agreement on hold, and has signaled that state and federal government funds will be used to build the port instead. Barnett has also signaled that the restructured port development plans may not include a separate rail tender, thereby cutting out a future opportunity for Yilgarn. Barnett has also spoken out strongly in public against "foreign control" of the port, which Yilgarn CEO Saunders believes is targeting Chinese investment, assumed to be controlled by China's central government. Barnett recently faced heated criticism in the State Parliament for his handling of the port tender process. Yilgarn's Saunders told us that the issue of port ownership has become a political football and is contributing to increasing xenophobia in the press and among the WA public over Chinese investment.

COMMENT

¶11. (C) Almost all the interlocutors we spoke with believe the Chinalco - Rio Tinto deal will go through in some form, and that more Chinese investment activity is likely to follow over the

next few years. There is a sense of inevitability about the outcome: business leaders believe the FIRB will have no choice but to recommend the Chinalco deal and that Treasurer Wayne Swan will approve because saying no means Rio will lay off workers at a difficult economic time. Most WA observers expect that the Federal government's regulatory agencies and political leadership will find a way to balance Australia's immediate economic interests with its long-term need to avoid anti-competitive control of the country's mineral assets. However, as the national debate over Chinese investments heats up, a minority in WA are looking to Canberra for a different solution. A few, like finance high-flier John Poynton, of Azure Capital, believe that the Federal government should use Australia's national Future Fund to provide financing for cash-strapped industries as a safer alternative to big Chinese investments. That said, WA's tradition of welcoming foreign investment, and its need to continue developing major resources projects, make continued support for the China economic partnership strong, at least in this state. End Comment.
CHERN